

June 30, 2003

To: Governor Kathleen Sebelius, and the Legislative Budget Committee

From: The Kansas Division of the Budget and the Kansas Legislative Research Department

Re: Revised State General Fund Receipts for FY 2003 and FY 2004

Estimates for the State General Fund are developed using a consensus process that involves the Division of the Budget, the Legislative Research Department, Department of Revenue, and three consulting economists from state universities. This estimate is the base from which the Governor and the Legislature build the annual budget.

The Consensus Group met on April 22, 2003, to revise the FY 2003 and FY 2004 estimates made in November 2002. The estimate of total tax receipts was reduced by \$227.1 million over the two years.

For FY 2003, the estimate of tax receipts decreased by \$99.1 million, or 2.3 percent, below the previous estimate that was made in November 2002. Even though estimated tax receipts are projected to fall, the overall revised State General Fund estimate of \$4.234 billion is \$82.3 million (2.0 percent) above the November estimate. This latter amount includes changes in transfers as a result of legislation enacted prior to April 22 that eliminated the KDOT repayment, eliminated transfers to local governments, and transferred other fund balances to the State General Fund.

For FY 2004, the estimate of tax receipts is \$4.320 billion, which is \$128.0 million, or 2.9 percent, below the original FY 2004 figure. The overall revised State General Fund estimate of \$4.392 billion is \$133.6 million, or 3.0 percent, less than the November estimate.

Detailed information regarding the specific sources of revenue constituting total receipts is presented in Table 1. Table 2 compares the FY 2003 estimate developed last fall with the recently

revised estimate. Table 3 compares the FY 2004 estimate developed last fall with the revised estimated for FY 2004.

Economic Forecast for Kansas

The Kansas economy is expected to realize modest growth; however, it is not expected until calendar year 2004. This is later than anticipated in November 2002 when the growth was expected as early as the latter part of calendar year 2003. Several key factors that affected the consensus estimates include uncertainty associated with the war in Iraq and the possibility of a double-dip recession, limited capital investments by businesses, increasing unemployment, and dampening retail sales.

The national economy still is expected to strengthen over the next two years. Nominal Gross Domestic Product (GDP) is expected to grow by 4.4 percent in 2003 and by 5.8 percent in 2004, while real GDP is expected to grow by 2.6 percent and 3.9 percent, respectively. U.S. personal income also is expected to increase. The growth is anticipated to be 3.9 percent in 2003 and 5.0 in 2004. A listing of the key economic indicators are shown in the following table:

Key Economic Indicators

	2001	2002	2003	2004
Consumer Price Index for All Urban Consumers	2.8 %	1.6 %	2.3 %	1.9 %
Real U.S. Gross Domestic Product	0.3	2.4	2.6	3.9
Nominal U.S. Gross Domestic Product	2.6	3.6	4.4	5.8
Nominal U.S. Personal Income	3.3	2.8	3.9	5.0
Corporate Profits before Taxes	-7.7	-2.0	10.0	12.0
Nominal Kansas Gross State Product	2.5	3.8	4.6	5.6
Nominal Kansas Personal Income:				
Dollars in millions	\$76,973	\$80,360	\$83,490	\$87,665
Percentage Change	3.8 %	4.4 %	3.9 %	5.0 %
Nominal Kansas Disposable Income:				
Dollars in millions	\$66,307	\$70,250	\$72,640	\$75,658
Percentage Change	4.0 %	6.0 %	3.4 %	4.2 %
Nominal Kansas Spendable Income:				
Dollars in millions	\$71,720	\$74,850	\$77,850	\$82,055
Percentage Change	3.7 %	4.4 %	4.0 %	5.4 %
Nominal Kansas Taxable Income:				
Dollars in millions	\$65,000	\$67,300	\$70,175	\$74,500
Percentage Change	3.1 %	3.5 %	4.3 %	6.2 %
Interest Rate for State General Fund (based on fiscal year)	5.96	2.75	1.63	2.00
Kansas Unemployment Rate (based on fiscal year)	4.1	4.7	5.0	5.1

Inflation Rate

In 2002, the rate of inflation, as measured by the Consumer Price Index for All Urban Consumers (CPI-U), was 1.6 percent. The inflation rate in 2003 is expected to be higher at 2.3 percent. The rate is anticipated to be slightly lower during the following year with an expected rate of 1.9 percent.

Kansas Personal Income

Kansas Personal Income (KPI) grew by 3.8 percent in 2001 and is expected to complete 2002 at the higher growth rate of 4.4 percent. The KPI growth rate is expected to be 3.9 percent in 2003 and 5.0 percent in 2004.

Interest Rates

The Pooled Money Investment Board is authorized to make investments in US Treasury and agency securities, highly rated commercial paper, and to repurchase agreements and certificates of deposit of Kansas banks. In FY 2002, the state earned 2.75 percent on its State General Fund portfolio. The average rate of return forecasted for FY 2003 is 1.63 percent. For FY 2004, the forecasted rate is 2.00 percent.

Employment

Labor market statistics indicate that unemployment in Kansas continues to increase and the long-term outlook is less than optimistic. The slowdown in the aircraft industry in Wichita is expected to continue and the telecommunications cutbacks in the Kansas City area provide additional pessimism in the Kansas labor market. The statewide unemployment rate for FY 2003 is expected to be 5.0 percent even though the Kansas total unemployment rate was 5.1 percent for the first eight months of FY 2003. The latest statistics indicate that Kansas unemployment is still below the national rate of 5.9 percent (February 2003) and that while unemployment levels are on the rise, they remain below the recessionary periods in 1993/1994 and 1982/1983. The overall Kansas unemployment rate for FY 2004 is expected to be 5.1 percent.

Agriculture

The March All Farm Products Index of Prices received by Kansas farmers, at 101.0 percent of the 1990-92 base, was down three points from February 2003, but up seven points from March 2002. The monthly average prices farmers received for wheat, corn, sorghum, and soybeans were down from the previous month, but up from a year ago. Hog prices were up from the previous month, but lower than a year ago, while all beef cattle prices were down from February, but higher than March 2002.

Oil and Gas

The average price per taxable barrel of Kansas crude oil is estimated to be \$25.50 in FY 2003 and to decrease to \$23 in FY 2004. Gross oil production in Kansas, which has been declining steadily for the last decade, is expected to continue to decline throughout the forecast period. Production is estimated to be 32.5 million barrels in FY 2003 and 32.0 million barrels in FY 2004.

The price of natural gas is expected to increase from the FY 2002 level of \$2.45 per mcf to \$3.45 per mcf in FY 2003 and then to \$3.70 per mcf in FY 2004. Natural gas production in FY 2002 was 468.0 million cubic feet. Production is expected to continue to decline for the foreseeable future as natural gas reserves, especially those in the Hugoton field, are depleted. The forecast is for 430.0 million cubic feet in FY 2003 and 395.0 million cubic feet in FY 2004.

Accounts Receivable

During the 2001 Legislative Session, the Department of Revenue received the resources and the authority to enhance its collection efforts on past due tax payments. The Department began implementation in July 2001, and was at full capacity by January 2002. Enhanced collections for FY 2002 totaled \$20.0 million, of which \$15.0 million was credited to the State General Fund. The Department anticipates that enhanced collections efforts will yield \$15.0 million to the State General Fund in FY 2003 and FY 2004, which is a significant reduction from the November 2002 estimate of \$37.6 million to the State General Fund for FY 2003 and FY 2004.

Tax Amnesty

In January 2003, the Governor proposed, and the Department of Revenue implemented, an administrative tax amnesty program. The Department estimates that this program will generate an additional \$12.5 million in FY 2003.

Enacted Legislation Affecting the Estimate

Occasionally the Legislature will enact new laws that affect State General Fund receipts prior to the spring consensus revenue estimating meeting. Two such laws were signed enacted prior to the April 22, 2003 meeting. Substitute for HB 2026 was signed into law during March 2003 and Substitute for HB 2208 was signed into law during April 2003. Both bills were considered and factored into the April estimates.

Substitute for HB 2026 was the supplemental appropriations bill for FY 2003 and affected transfers to and from the State General Fund.

Substitute for HB 2208 amends tax increment financing (TIF) laws to provide statewide authority for sales tax and revenue (STAR) bonds to be used to finance special bond projects of

regional or statewide importance. STAR bond financing allows state and local sales tax revenues to be used to finance bonds issued for infrastructure costs associated with a qualified project. In order to qualify as a special bond project the project must have at least a \$50.0 million capital investment and \$50.0 million in projected gross annual sales revenues or be located outside of metropolitan statistical areas when the Secretary of Commerce has found the project to be in an eligible area under TIF law and of regional or statewide importance.

It is anticipated that, to the extent that retail establishments are included in STAR bond areas, the State General Fund will lose revenue due to the passage of Sub for HB 2208. This is because purchases that would otherwise have been made at established businesses collecting sales tax to be placed in the State General Fund will be shifted to new businesses located within the special bond project area collecting sales tax to be placed in a STAR bond repayment fund. While the extent of this shift is not known, it is an area that should be monitored closely for future consensus revenue estimating purposes.

State General Fund Receipts Estimates

Each individual State General Fund source was reevaluated independently and consideration was given to revised and updated economic forecasts, and year-to-date receipts. Additional information was provided by the Department of Revenue, the Insurance Department, the Secretary of State's Office, the State Treasurer's Office, the Pooled Money Investment Board, and the Kansas Department of Human Resources.

Tax Receipts

FY 2003. Estimated tax receipts for FY 2003 were decreased by \$99.1 million. Individual income tax receipts account for \$65.0 million of the total decrease. The significant reduction to the estimate is based on a weak economy, the uncertainty surrounding the effects of the war with Iraq, decreased capital gains realizations, and increased capital losses. Likewise, the corporation income tax estimate was reduced by \$20.0 million from \$125.0 million to \$105.0 million.

The retail sales tax estimate also was reduced by \$30.0 million for FY 2003 from \$1,600.0 million to \$1,570.0 million. This reduction was based on slower than expected consumer spending through the first three quarters of the fiscal year and the expectation that the pattern will continue throughout the rest of FY 2003.

The estate tax estimate was reduced by \$5.0 million from \$55.0 million to \$50.0 million because of timing and administrative issues associated with the class "C" inheritance tax (succession tax). Legislative changes made during the 2002 session were estimated to increase receipts by \$15.0 million. However, recent analysis indicates that those receipts are not likely to materialize. Other tax source estimates that were reduced include the cigarette tax (-\$2.0 million), cereal malt beverage (-\$100,000), liquor gallonage (-\$300,000), and the severance tax on oil (-\$900,000).

An increase is expected in insurance premiums in FY 2003. The estimate was increased by \$7.0 million from \$85.0 million to \$92.0 million. The increase is due to rate increases, especially in health related policies. Increases were made to estimates for other tax sources, as well. Severance tax receipts for natural gas are expected to increase by \$8.2 million because of higher than expected prices. Receipts from liquor enforcement are expected to increase by \$500,000. Miscellaneous tax receipts also are expected to increase by \$500,000. Financial institutions income tax receipts are forecast to increase during FY 2003 by \$2.5 million, and corporate franchise tax receipts are anticipated to increase by \$5.0 million.

FY 2004. The estimate of tax receipts for FY 2004 is \$4.320 billion, which is \$128.0 million, or 2.9 percent, below the original FY 2004 figure. The overall revised State General Fund estimate of \$4.392 billion is \$133.6 million, or 3.0 percent, less than the November estimate.

The decrease from the original estimate is attributable to large downward revisions in individual income tax receipts (-\$75.0 million), corporate income tax receipts (-\$35.0 million), estate tax receipts (-\$10.0 million), and retail sales tax receipts (-\$30.0 million). These decreases were offset slightly by increases in estimated receipts for various excise taxes and insurance premium taxes.

Accuracy of Consensus Revenue Estimates

For 29 years, State General Fund revenue estimates for Kansas have been developed using the consensus revenue estimating process. Besides the three state agencies identified on the first page, the economists currently involved in the process are Joe Sicilian from the University of Kansas, Ed Olson from Kansas State University, and John Wong from Wichita State University. Each of the entities and individuals involved in the process prepared independent estimates and met on April 22, 2003, to discuss estimates and come to a consensus for each fiscal year.

The following table presents estimates compared to actual receipts since FY 1975, the fiscal year for which the current process was initiated. The process involves comparing the adjusted original estimate to actual collections and then the final estimate is compared to actual receipts.

STATE GENERAL FUND ESTIMATES

Fiscal Year	Adjusted Original Estimate*	Adjusted Final Estimate**	Actual Receipts	Difference from:			
				<u>Original Estimate</u>	<u>Final Estimate</u>	<u>Original Estimate</u>	<u>Final Estimate</u>
				Amount	Percent	Amount	Percent
1975	\$ --	\$ 614.9	\$ 627.6	\$ --	-- %	\$ 12.7	2.1 %
1976	676.3	699.7	701.2	24.9	3.7	1.4	0.2
1977	760.2	760.7	776.5	16.3	2.1	15.8	2.1
1978	830.1	861.2	854.6	24.5	3.0	(6.5)	(0.8)
1979	945.2	1,019.3	1,006.8	61.6	6.5	(12.5)	(1.2)
1980	1,019.3	1,095.9	1,097.8	78.5	7.7	1.9	0.2
1981	1,197.1	1,226.4	1,226.5	29.4	2.5	0.1	--
1982	1,351.3	1,320.0	1,273.0	(78.3)	(5.8)	(47.0)	(3.6)
1983	1,599.2	1,366.9	1,363.6	(235.6)	(14.7)	(3.2)	(0.2)
1984	1,596.7	1,539.0	1,546.9	(49.8)	(3.1)	7.9	0.5
1985	1,697.7	1,679.7	1,658.5	(39.2)	(2.3)	(21.3)	(1.3)
1986	1,731.2	1,666.4	1,641.4	(89.8)	(5.2)	(25.0)	(1.5)
1987	1,903.1	1,764.7	1,778.5	(124.6)	(6.5)	13.8	0.8
1988	1,960.0	2,031.5	2,113.1	153.1	7.8	81.6	4.0
1989	2,007.8	2,206.9	2,228.3	220.5	11.0	21.4	1.0
1990	2,241.2	2,283.3	2,300.5	59.3	2.6	17.2	0.8
1991	2,338.8	2,360.6	2,382.3	43.5	1.9	21.7	0.9
1992	2,478.7	2,454.5	2,465.8	(12.9)	(0.5)	11.3	0.5
1993	2,913.4	2,929.6	2,932.0	18.6	0.6	2.4	0.1
1994	3,040.1	3,126.8	3,175.7	135.6	4.5	48.9	1.6
1995	3,174.4	3,243.9	3,218.8	44.4	1.4	(25.1)	(0.8)
1996	3,428.0	3,409.2	3,448.3	20.3	0.6	39.0	1.1
1997	3,524.8	3,642.4	3,683.8	159.0	4.5	41.4	1.1
1998	3,714.4	3,971.0	4,023.7	309.3	8.3	52.7	1.3
1999	3,844.7	4,051.9	3,978.4	133.7	3.5	(73.4)	(1.8)
2000	4,204.1	4,161.0	4,203.1	(1.0)	--	42.1	1.0
2001	4,420.7	4,408.7	4,415.0	(5.7)	(0.1)	6.4	0.1
2002	4,595.8	4,320.6	4,108.7	(565.6)	(12.1)	(211.7)	(4.9)

* The adjusted original estimate is the estimate made in November or December prior to the start of the next fiscal year in July and adjusted to account for legislation enacted, if any, which affected receipts to the State General Fund.

** The final estimate made in March or April is the adjusted original estimate plus or minus changes subsequently made by the Consensus Estimating Group. It also includes the estimated impact of legislation on receipts.

Concluding Comments

Consensus revenue estimates are based on current federal and state laws and their current interpretation. The group will meet again in November 2003 to revise these estimates. Developments which occur between the April and November meetings will be taken into account at that time.